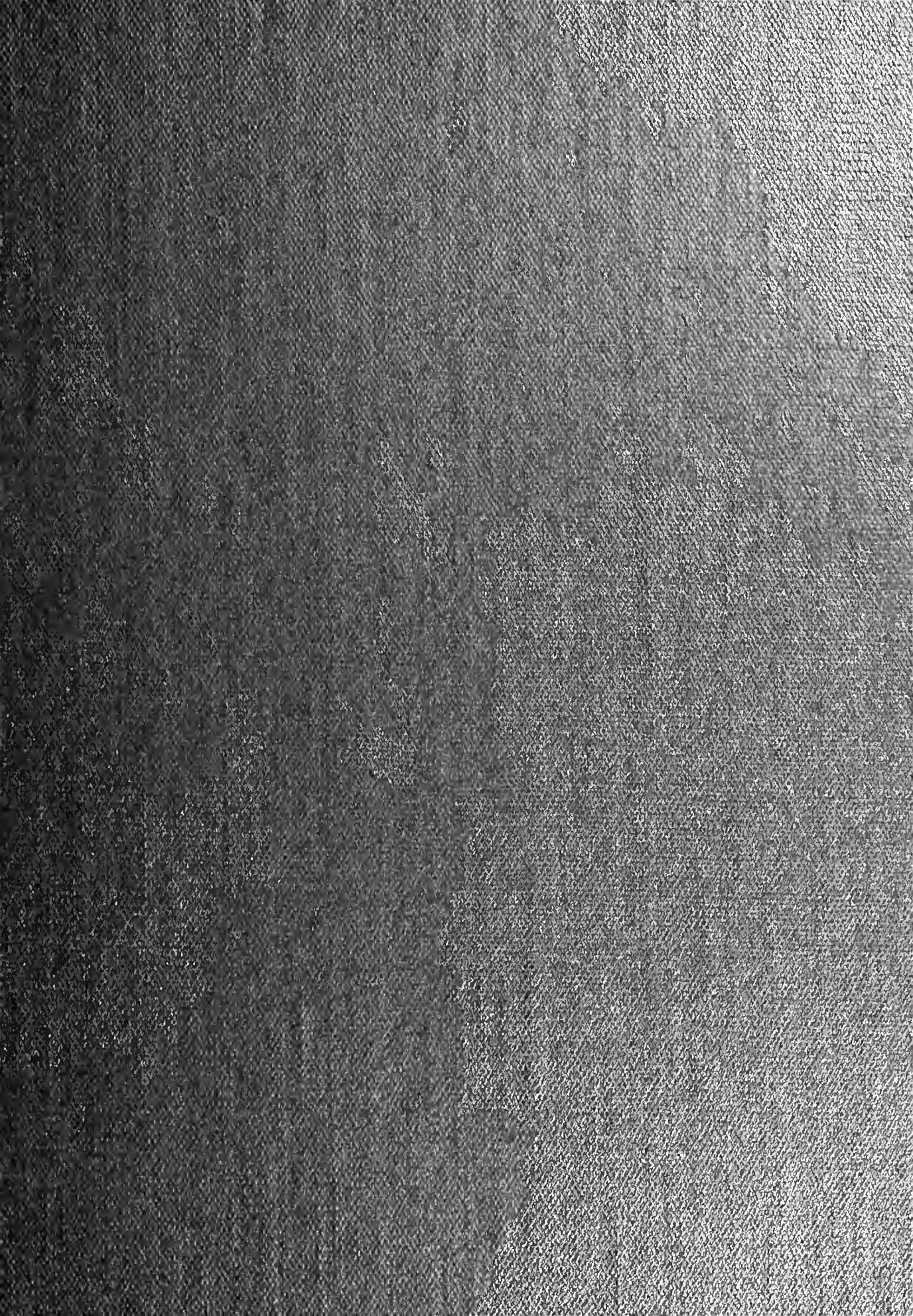

LEGISLATIVE

RESEARCH COMMISSION

REPORT

TO THE

1979

GENERAL ASSEMBLY OF NORTH CAROLINA

SECOND SESSION, 1980

REVENUE LAWS

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STATE OF NORTH CAROLINA

LEGISLATIVE RESEARCH COMMISSION

STATE LEGISLATIVE BUILDING

RALEIGH 27611

June 5, 1980

TO THE MEMBERS OF THE 1980 GENERAL ASSEMBLY:

Transmitted herewith is the report prepared by the Committee on Revenue Laws of the Legislative Research Commission. The study was conducted pursuant to Senate Joint Resolution 94 (ratified Resolution 83) of the 1979 General Assembly (First Session, 1979). This report is submitted to the members of the General Assembly for their consideration.

Respectfully submitted,

Carl J. Stewart, Jr.

W. Craig Lawing

Co-Chairmen

LEGISLATIVE RESEARCH COMMISSION

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PREFACE

The Legislative Research Commission, authorized by Article 6B of Chapter 120 of the General Statutes, is a general purpose study group. The Commission is co-chaired by the Speaker of the House and the President Pro Tempore of the Senate and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

At the direction of the 1979 General Assembly, the Legislative Research Commission has undertaken studies of numerous subjects. These studies were grouped into broad categories, and each member of the Commission was given responsibility for one category of studies. The Co-Chairmen of the Legislative Research Commission, under the authority of General Statutes 120-30.10(b) and (c), appointed committees consisting of members of the General Assembly and of the public to conduct the studies. Co-Chairmen, one from each house of the General Assembly, were designated for each committee.

The study of the revenue laws was directed by Senate Joint Resolution 94 (ratified Resolution 83) of the 1979 General Assembly (First Session, 1979). The charge to the Committee in

Section 2 of the Resolution is to continue the study of revenue laws of the State of North Carolina. A copy of this Resolution may be found in Appendix III of this report along with membership lists of the Legislative Research Commission and the Committee on Revenue Laws.

SUMMARY LIST OF RECOMMENDED LEGISLATION

This report contains, beginning on page 2, the findings and recommendations of the Legislative Research Commission's Committee on Revenue Laws. Following the title of each proposed bill is the page number of this report on which the discussion of that proposal begins. A copy of each proposed bill is contained in Appendix I of this report.

Legislative Proposal 1 -- AN ACT TO REMOVE THE REQUIREMENT THAT THE TAX REVIEW BOARD APPROVE REGULATIONS ISSUED BY THE SECRETARY OF REVENUE (p. 3).

Legislative Proposal 2 -- AN ACT TO ALLOW THE SECRETARY OF REVENUE DISCRETION ON REQUIRING AN AUDIT BEFORE ALLOWING A REFUND OF MOTOR FUEL TAX (p. 4).

Legislative Proposal 3 -- AN ACT TO CONFORM THE FEE FOR REISSUING A SALES OR USE TAX LICENSE WHEN THE LICENSE HAS BEEN SUSPENDED OR REVOKED TO THE SAME FEE AS ISSUANCE OF A NEW LICENSE (p. 4).

Legislative Proposal 4 -- AN ACT TO RAISE THE MINIMUM TAX THRESHOLD FOR PAYMENT OF INTANGIBLES TAX TO REFLECT INFLATION SINCE 1963, SO AS TO REDUCE THE NUMBER OF PERSONS LIABLE FOR INTANGIBLES TAX (p. 5).

Legislative Proposal 5 -- AN ACT TO ALLOW NONRESIDENTS, FILING NORTH CAROLINA RETURNS, TO APPORTION PERSONAL DEDUCTIONS BETWEEN NORTH CAROLINA AND THEIR STATES OF PRINCIPAL RESIDENCE TO THE EXTENT THAT THEIR STATES OF PRINCIPAL

COMMITTEE PROCEEDINGS

The Committee on Revenue Laws was appointed by the Co-Chairmen of the Legislative Research Commission pursuant to Senate Joint Resolution 94 (ratified Resolution 83) of the 1979 General Assembly (First Session, 1979). Senator Carolyn Mathis was named as Legislative Research Commission member with responsibility for the study. Senator Marshall A. Rauch and Representative Daniel T. Lilley were appointed Co-Chairmen of the Committee. A membership list of the Committee is contained in Appendix III.

The organizational meeting of the Committee was held October 23, 1979, at which time the Committee was divided into two subcommittees to which various portions of the revenue laws were assigned. A list of the topics assigned to each subcommittee is presented in Appendix IV. There have been a total of six committee meetings.

The recommendations in this report were developed in the subcommittees, then discussed and approved by the full Committee. The subcommittees were assisted by the division directors of the Department of Revenue. A list of the persons from the Department of Revenue who worked with the Committee is presented in Appendix V. A list of other persons making presentations is also contained in Appendix V.

The Committee wishes to note its appreciation of the diligence with which Mr. Mark Lynch, Secretary of Revenue, Mr. James Senter, Deputy Secretary of Revenue, and many other

officials from the Department of Revenue provided necessary data and assistance to the Committee.

FINDINGS AND RECOMMENDATIONS

PART I. RECOMMENDATIONS ACCOMPANIED BY LEGISLATIVE PROPOSALS

(All legislative proposals are contained in Appendix I of this report. They are numbered sequentially beginning with Legislative Proposal 1, and each recommendation below refers to the legislative proposal which would implement it.)

The Legislative Research Commission's Committee on Revenue Laws, after a review of all the information and data it has gathered, and for the reasons set forth below, makes the following recommendations:

1. Review and approval by the Tax Review Board of Department of Revenue regulations should cease. (Legislative Proposal 1).

G.S. 105-262 and G.S. 105-113.102 require that the Tax Review Board approve all regulations promulgated by the Department of Revenue. The Tax Review Board consists of the State Treasurer, the Chairman of the Utilities Commission, one gubernatorial appointee, and the Secretary of Revenue, who does not vote on regulations he submits to the Board.

Although the provision for Tax Review Board approval of regulations has existed since 1955, several statutory provisions make the approval unnecessary. G.S. 120-30.28 provides that revenue regulations are to be reviewed by the Administrative Rules Review Committee of the Legislative Research Commission. While the Administrative Procedures Act in G.S. 150A-1(a) exempts

the Department of Revenue from holding public hearings on regulations, the Superior Court can hear appeals from regulations, and G.S. 150A-59 requires that rules be filed with the Attorney General.

State Treasurer Harlan Boyles, Chairman of the Tax Review Board, supports the above recommendation of the Committee, because it will simplify the process. (See Appendix VI). The Department of Revenue also supports and requests the recommendation because the present review process is deemed sufficient.

2. The current mandatory annual audit of firms requesting motor fuel tax refunds should be made discretionary with the Secretary of Revenue. (Legislative Proposal 2).

G.S. 105-449.39 mandates that audits of firms requesting motor fuel tax refunds be conducted annually. In many small cases, the cost of the audit exceeds the amount of the refund; therefore, the Department of Revenue requested that the mandatory annual audit be made discretionary with the Secretary of Revenue.

The current statute of limitations would allow the Secretary to audit the firm's books for three previous years if problems were discovered with a particular firm.

3. The fee for reissuing a sales or use tax license to a retailer when the license has been suspended or revoked should be the same fee as for issuance of a new sales or use tax license. (Legislative Proposal 3).

The Legislative Research Commission Committee on Revenue Laws recommended in 1978, and the General Assembly enacted in

1979 in Chapter 17 of the Session Laws of 1979, amendments to G.S. 105-164.4(7) and G.S. 105-164.6(7) raising the fee for a new sales and use tax license (merchant's certificate of registration) from one dollar ($1.00) to five dollars ($5.00). The 1979 legislation overlooked raising the fee provided for in G.S. 105-164.29 for reissue of a suspended or revoked sales or use tax license.

The Department of Revenue recommended and the Committee agreed that the reissue fee also be raised to five dollars ($5.00).

4. The minimum tax threshold for filing an intangibles tax return should be increased to adjust for inflation since 1963. (Legislative Proposal 4).

The 1963 General Assembly by enacting G.S. 105-214 set a five dollar ($5.00) intangibles tax threshold for intangibles other than money on deposit, so that a person whose intangibles tax did not exceed five dollars ($5.00) would not have to file a return. The threshold is the equivalent of providing that any person owning less than two thousand dollars ($2,000) of intangibles, other than money on deposit, is not required to pay intangibles tax. Pursuant to G.S. 105-199, money on deposit is not taxed unless an account contains one thousand dollars ($1,000).

To adjust for inflation, including projected 1980 inflation, in round figures the intangibles tax threshold in G.S. 105-214 would be raised to fifteen dollars ($15.00) by January 1, 1981. Increasing the threshold to fifteen dollars ($15.00) would be the

equivalent of stating that persons owning less than six thousand dollars ($6,000) of stocks, bonds, and similar items would not have to file intangibles tax returns.

The adjustment for inflation would remove twenty-two percent (22%) of the total taxpayers from the intangibles tax on stocks, bonds, and similar items.

5. Qualified nonresidents, filing North Carolina income tax returns, should be allowed to apportion their personal deductions between North Carolina and their states of principal residence to the extent that their states of principal residence allow similar apportionment of personal deductions by nonresidents filing returns in that state. (Legislative Proposal 5).

Currently, North Carolina law, as statutorily expressed in G.S. 105-147(18), only permits nonresidents filing returns deductions which "...are connected with income arising from sources within the State..." and the charitable contribution deduction for qualified nonresidents.

The North Carolina position on nonresidents claiming personal deductions was upheld in a 1955 Attorney General's opinion and in J. C. Stiles v. James S. Currie, Commissioner of Revenue, 254 N.C. 197 (1961) in which the North Carolina Supreme Court said that the statute limiting the right of a nonresident taxpayer, in computing his net income taxable by this State, to claim only those deductions which are related to his business in this State, was valid and did not constitute an unlawful discrimination in violation of Article IV, § 2 of the North Carolina Constitution and the Fourteenth Amendment of the United

States Constitution. The Court reasoned that nonresidents are not permitted personal deductions allowed to residents of this State, since only the income of the nonresidents earned within this State is subject to individual income taxes here.

North Carolina's unwillingness to allow apportionment of personal deductions by nonresidents filing income tax returns has been a source of serious concern particularly for the many South Carolina residents who work in North Carolina and file North Carolina income tax returns. This concern had so intensified that the South Carolina General Assembly reacted by enacting Act 169 of the 1979 Acts and Joint Resolutions of South Carolina. That Act was entitled "An Act To Amend Section 12-7-750, Code Of Laws Of South Carolina, 1976, Relating To Deductions Allowed Nonresident Individuals When Filing State Income Tax Returns, So As To Provide That A Nonresident Individual Shall Not Be Permitted To Apportion His Nonbusiness Deductions Between This State And His State Of Principal Residence Unless His State Of Principal Residence Also Permits Such Apportionment And Allocation Of Nonbusiness Deductions By Nonresident Individuals Filing Returns In That State." Act 169 changed the previous South Carolina position of allowing unqualified apportionment of personal deductions by nonresidents filing returns to a reciprocal stance by which allowance of apportionment is dependent on the availability of apportionment in the nonresident's state of principal residence.

Legislative Proposal 5 would attempt to correct inequities to nonresidents in computing net taxable income by allowing

apportionment of personal deductions by nonresidents whose states of principal residence allow similar apportionment of personal deductions.

6. The sales and use tax exemption for exports to a foreign country for exclusive use and consumption in that foreign country should be clarified to prevent exemption of items which were not intended to be exempt by the General Assembly. (Legislative Proposal 6).

Under various North Carolina Supreme Court decisions, goods shipped directly overseas by North Carolina merchants or manufacturers have always been exempt from the sales and use tax. Goods purchased and picked up by the buyer have been subject to the sales and use tax.

The 1979 General Assembly enacted G.S. 105-164.13(33), effective July 1, 1979, to exempt "tangible personal property purchased exclusively for the purpose of export to a foreign country for exclusive use and consumption in that foreign country and which purpose is consummated." When the export is not consummated, the vendee is liable for the applicable tax.

The intent of the General Assembly as expressed in the exemption was "...to encourage the flow of commerce through North Carolina ports that is now moving through out-of-state ports"; however, the term "export" has a broad definition and could include purchases of tangible personal property by individuals who transport the property to a foreign country themselves. With the exemption having such a broad scope, purchases of personal use items which are to be used exclusively in another country but

are actually carried out of this country by the purchaser could qualify for the exemption. Interpretation by the Department of Revenue, however, has excluded from the exemption any property which may be purchased and used in North Carolina in any manner prior to the purchaser carrying the property with him to a foreign country.

The Committee approved Legislative Proposal 6 to close any possible loopholes in the exemption and to make certain that the intent of the 1979 General Assembly was carried out. The Secretary of the North Carolina Department of Commerce, Mr. D. M. Faircloth, expressed support for the proposal on behalf of the State Ports Authority as well as his department. (See Appendix VII).

7. The North Carolina and local use tax credits for sales tax paid in another State or locality outside North Carolina should be given only on a reciprocal basis. (Legislative Proposal 7).

Legislative Proposal 7 is a reaction to a South Carolina tax inequity against North Carolinians, which was brought to the attention of the Committee.

South Carolina Code § 12-35-810 levies a use tax of four percent (4%), but South Carolina Code § 12-35-820 gives a sales tax credit against the use tax only for South Carolina sales tax payments. The only exception to this rule is a reciprocal credit provision on sales and use tax charged on construction equipment brought into this State.

In contrast, North Carolina General Statutes § 105-164.6(4)

allows a credit against the North Carolina use tax for out-of-state sales tax paid, while G.S. 105-467 of the Local Government Sales and Use Tax Act only gives credit for local sales taxes paid in other states and not for state sales taxes.

In a case recounted by a subcommittee witness, a North Carolina contractor bought materials from a North Carolina supplier and accepted delivery in North Carolina for use in South Carolina. Even though the use was intended to be in South Carolina, the North Carolina Supreme Court in Excel Inc. v. Clayton, 269 N. C. 127 (1967) stated that such a transaction was subject to the North Carolina sales tax.

On the other hand, if the contractor had requested the supplier to ship the materials to South Carolina, Excel Inc. v. Clayton would have exempted the transaction from sales tax because of the Commerce Clause of the United States Constitution.

The result of the North Carolina statute, the South Carolina statute, and the North Carolina Supreme Court case is essentially to make it cheaper for North Carolina contractors doing business in South Carolina to either buy the products in South Carolina or have the seller take responsibility for shipping, a more expensive proposition. The only two states which deny use tax credit are South Carolina and West Virginia.

Twelve states have eliminated the effect of the unfairness by making their credits reciprocal only with states giving similar credits. A reciprocal use tax credit would put pressure on South Carolina to change its law. If South Carolina does not change its law, South Carolina contractors doing business in

North Carolina could buy from North Carolina suppliers to avoid the double tax.

Georgia, the other state bordering South Carolina, already has a reciprocal credit.

Legislative Proposal 7, which is patterned after existing legislation in Alabama and Kentucky, provides that the use tax credit for sales tax paid in another state or locality outside North Carolina is to be reciprocal only with states giving similar credit to North Carolina.

The effective date of the proposal is July 1, 1981, so as to allow South Carolina to amend its law before the North Carolina statute takes effect.

8. A prime contractor should be jointly liable with a subcontractor for use tax unless the subcontractor's affidavit that the tax has been paid was furnished to the contractor. (Legislative Proposal 8).

G.S. 105-164.6(3) imposes a use tax upon the purchase price of all building materials, supplies, fixtures or equipment which shall become a part of any building or structure or which are annexed to or in any manner become a part of a building. The law levies the tax against the purchaser of the tangible personal property and provides that there shall be a joint liability for the tax against both the contractor and the owner, but the liability of the owner shall be satisfied if an affidavit is required of the contractor and furnished by him before final settlement is made showing that the tax levied has been paid in full.

Sometimes contractors subcontract portions of the general contracts and when this is done, the subcontractors become the purchasers of the tangible personal property which they use in performing these subcontracts. Contractors and subcontractors are users or consumers of the property which they purchase and use in performance of contracts and are liable for payment of the applicable tax thereon, either to vendors, where applicable, or directly to the Secretary of Revenue. Even though the Secretary of Revenue has the authority to assess the owners of the property, as stated above, the contractors or the subcontractors are the purchasers of the tangible personal property involved and, as provided by statute, the tax is levied against the purchasers of such property.

While the Department of Revenue can assess the owners, it is entirely possible that the contractors and subcontractors have performed more than the one contract in this State and are liable for payment of applicable taxes on all purchases used in performance of such contracts. The records of the property owner may not reflect the subcontractors that perform subcontracts even if the property owner has obtained the prescribed affidavit from the prime or general contractor and, therefore, based upon the owner's records, the Department of Revenue may have no indication whether the tax levied has been paid.

The Committee felt that it would be helpful to amend the statute to require the prime or general contractor to obtain affidavits from his subcontractors or, in the absence of obtaining such affidavits, to make the prime or general

contractor liable for tax due on purchases of such materials, supplies, fixtures and equipment by the subcontractors since such contractor has obtained or acquired the tangible personal property in question through the subcontractor, until evidence is presented which shows that the tax has been paid by the subcontractor. If the affidavit is obtained, the contractor would be in a position to certify to the property owner that the taxes levied in this subsection have been paid. In the absence of an affidavit in the hands of the property owner, the property owner or the contractor would be held liable for the taxes until it is evidenced that the taxes have been paid.

Legislative Proposal 8 clarifies G.S. 105-164.6(3) without requiring that the owner deal directly with subcontractors.

9. Garnishees should be able to respond to notices of garnishment under the Revenue Act and the Machinery Act by certified as well as registered mail. (Legislative Proposal 9).

Provisions of the Revenue Act, G.S. 105-242(b), and the Machinery Act, G.S. 105-368(c) and G.S. 105-368(d), require that garnishees respond to notices of garnishment for state and local taxes by registered mail.

Legislative Proposal 9 would allow certified mail to be used also for cost reasons, since currently, registered mail costs $3.15 while certified mail costs 95 cents.

10. Additional funds should be appropriated to the Legislative Research Commission for the 1980-81 fiscal year for further study by the Committee on Revenue Laws. (Legislative Proposal 10).

The Committee on Revenue Laws has long been an excellent forum which State officials, statewide organizations, and taxpayers could use for consideration of complaints and difficulties with the revenue laws. The Committee has always endeavored to make technical revisions and substantive changes in the revenue laws, which would well serve the State as a whole.

The time and budget limits placed on the Committee during the interim prevented further investigation of many areas of the revenue laws which desperately need further review. Both subcommittees have full agendas of remaining problem areas to be explored.

To halt the work of this Committee at this particular point would retard seriously the progress which has been made in improving the revenue laws.

11. Qualified personal property shipped into this State for repair and then reshipped to the owner outside this State should be exempt from ad valorem taxation. (Legislative Proposal 11).

G.S. 105-315(a) states that every person who has custody on January 1 "...of taxable tangible personal property..." entrusted to him by another "...for storage, sale, renting, or any other business purpose..." shall provide the tax supervisor of the county in which the property is situated with a statement showing "...the name of the owner of the property, a description of the property, the quantity of the property, and the amount of money, if any, advanced against the property by the person having custody of it." G.S. 105-304(d)(2) provides that "...tangible personal property owned by a domestic or foreign taxpayer (other

than an individual person) that has no principal office in this State shall be taxable at the place in this State at which the property is situated." "Situated" is defined in G.S. 105-304(b)(1) as "more or less permanently located."

These statutory provisions have combined to create a situation in which businesses with service or repair facilities in North Carolina have been unable to answer with any certainty questions by out-of-state customers or prospective customers about the length of time in which property being repaired or serviced could remain in North Carolina without having a tax situs here and being subject to ad valorem taxation.

The North Carolina Supreme Court ruled on the question of tax situs in In re Appeal of Hanes Dye & Finishing Co., 285 N.C. 598 (1974) and held that cloth materials of nonresident customers shipped from outside North Carolina to a textile finishing company for processing and reshipment to those customers or their customers at designated places outside North Carolina were not "situated" or "more or less permanently located" in the county in which the finishing company was located on January 1, of the year in question, and, therefore, did not have a tax situs in that county. However, even in light of this case, the factual determination of whether certain property is "more or less permanently located" in this State is still difficult.

Legislative Proposal 11 restates the current law and the Department of Revenue's interpretation of the law and makes it clear to local taxing authorities that tangible personal property shipped into this State to a business premise other than the

owner's business premise, for repair and reshipment to the owner outside the State will not be subject to ad valorem taxation. The proposal accomplishes this purpose without allowing raw materials in process of manufacture in this State an exemption from ad valorem taxation.

12. The statute exempting from sales tax certain labor service charges at establishments serving food, beverages, or meals should be clarified. (Legislative Proposal 12).

At the request of the North Carolina Restaurant Association and the North Carolina Innkeepers Association, the Committee reviewed the implementation of G.S. 105-164.13A (Section 76 of the Revenue Act of 1979), which attempted to partly overrule Sales Tax Ruling 71 of the Department of Revenue (STR-71).

STR-71 provided that surcharges for service charges on "...foods, meals, beverages, refreshments...for banquets, bars and dining rooms...." are subject to sales tax, and only voluntary tips are exempt from the sales tax.

G.S. 105-164.13A, the 1979 legislation, exempted service charges on pre-arranged group meals from the sales tax.

The Attorney General issued letter opinions which narrowly construed the statute. A letter opinion of August 7, 1979 adopted a very narrow definition of "meal". That opinion, citing a California case defining "meal", excluded items such as stand-up wedding receptions.

In a letter opinion of September 12, 1979, the Attorney General correctly noted that making a dinner reservation is not a contract, but then went on to say that since there are no

contracting parties, the exemption did not apply.

G.S. 105-164.13A does not require a written contract. When a person orders from a menu, and the waiter accepts the order, an oral contract has then been made. If the menu provides a fifteen percent (15%) service charge, then the service charge on the menu is incorporated into the contract just as is the price of the steak listed on the menu.

A Massachusetts revenue ruling on this subject was cited by the North Carolina Restaurant Association as a possible solution.

Legislative Proposal 12 adopts the substance of the Massachusetts revenue ruling, but exempts from taxation only the first fifteen percent (15%) of any service charge. In addition, payment of the service charge is to be made in accordance with G.S. 95-25.6. For the purposes of the North Carolina Wage and Hour Act, including minimum wage calculations, the service charge is to be considered a tip.

This proposal as approved by the Committee makes the following changes in the existing law: (1) there is no requirement for prearrangement; (2) the minimum of four persons is dropped; (3) the restriction on facilities is eliminated; (4) coverage is expanded to food and beverages; (5) requirements are set out as to how the charge is to be separately stated; (6) the service charge must be turned over to those directly involved in serving the food, beverages, and meals; and (7) the status of a service charge which exceeds fifteen percent (15%) and the status of the service charge under the North Carolina Wage and Hour Act are clarified.

While the proposal does not meet with the full agreement of the North Carolina Restaurant Association and the North Carolina Innkeepers Association, it is much clearer than the existing statute and broader in many respects.

13. Individuals should be given an income tax exclusion for interest received on savings as an incentive to saving and a boost to the depressed housing market. (Legislative Proposal 13).

The 1980's have begun with a dangerous decline in the amount which Americans are saving. The January 1980 savings gains at the nation's savings and loan associations are at the lowest point in ten years. The January savings gains were off sixty-eight percent (68%) from the figure reported one year ago. The decline in savings as well as a shift from passbook and lower-rate certificate accounts to the higher yielding six- and thirty-month money market certificates has been a stimulus for the depression of the housing market due to the decrease in capital available for home financing and other major capital expenditures.

Congress recognized the need for a tax incentive for savers during its current session when it enacted Section 404 of the Crude Oil Windfall Profit Tax Act of 1980. In part, Section 404 provides an exclusion from gross income for two hundred dollars ($200.00) (four hundred dollars ($400.00) in the case of a joint return) for interest received from savings deposits and certificates of deposit. The conference agreement on the bill restricted the exclusion to taxable years beginning after

December 31, 1980, and before January 1, 1983.

The Committee realized that the federal exclusion alone would not suffice as the only tax incentive for savers and, therefore, approved Legislative Proposal 13.

Legislative Proposal 13 provides an individual income tax exclusion from gross income for savings deposits and certificates of deposit in resident banks, credit unions, and savings and loan associations. The exclusion is allowed for an amount not to exceed two hundred dollars ($200.00) and applies to taxable years beginning on or after January 1, 1980.

14. The due dates of the special fuels tax report and the highway fuel use tax report should be changed to the last day of the month following the end of the calendar quarter. (Legislative Proposal 14).

Pursuant to G.S. 105-449.10, motor carriers must file a User Special Fuels Report listing vendors' names, place of purchase, and gallons of fuel purchased during the preceding calendar quarter. This report, an informational report used by the Department of Revenue for audit purposes, is due on the twenty-fifth of the month following the close of the quarter.

Motor carriers are also required under G.S. 105-449.42 and G.S. 105-449.45 to file a Highway Fuel Use Tax Report on a calendar quarter basis and to remit tax on motor fuels used in their operations within this State. The due date of this report is the twentieth of the month following the close of the preceding calendar quarter.

Legislative Proposal 14 changes the due date of both reports

to the last day of the month following the end of the calendar quarter. This change will allow the Department of Revenue to combine the reports into one report, and thereby comply with motor carriers' wishes as to combination of the two reports and change of due dates to the end of the month.

15. Interest upon docketed certificates of tax liability should accrue at the rate established under G.S. 105-241.1(i) which is currently twelve percent (12%). (Legislative Proposal 15).

Chapter 1114 of the Session Laws of 1977 changed the interest rate for delinquent taxes from a flat six percent (6%) to a floating rate to be determined under G.S. 105-241.1(i). Currently, that rate is twelve percent (12%).

The 1977 amendment did not cover the running of interest when a certificate or judgment for taxes is docketed with a clerk of superior court under G.S. 105-242(c). Under G.S. 24-1 and G.S. 24-5, interest on those items runs at only six percent (6%).

Legislative Proposal 15 changes that rate for items under G.S. 105-242(c) so it follows the interest rate set by the Secretary of Revenue under G.S. 105-241.1(i).

The proposal becomes effective with respect to interest accruing on or after July 1, 1980. Interest up to that date will be computed at the previous statutory rate of six percent (6%).

Part II.

Recommendations Not Accompanied By Legislative Proposals

16. Consideration of adoption of a federal individual income tax "tracking" statute should be deferred until such time as the Committee can reach a consensus on such a statute.

The Committee made an initial decision to investigate the adoption of a federal individual income tax "tracking" statute. A "tracking" statute accomplishes a shift by a state from an independent determination of individual income tax law to the approach of adopting the federal individual income tax law by reference.

Tracking statutes attempt to conform a state's individual income tax law to the federal individual income tax law. The various types of tracking statutes have been categorized by the extent of their conformity. A tracking statute is characterized as a "virtually complete" conformity tracking statute if the taxpayer's state income tax liability is determined solely by taking a percentage of the taxpayer's federal income tax liability. In this case the state accepts the federal adjusted gross income, exemptions, deductions, and rate schedule. Nebraska, Vermont, and Rhode Island currently have this type of tracking statute.

Tracking statutes which apply a state's tax rates to the federal net taxable income to determine state tax liability are

characterized as "substantial" conformity tracking statutes. In this instance the state accepts the federal adjusted gross income, exemptions, and deductions. At the present time, Alaska, Hawaii, Idaho, New Mexico, North Dakota, Oklahoma, Oregon, and Utah have enacted this type of tracking statute.

A "moderate" conformity tracking statute adopts the federal adjusted gross income, but adopts its own exemptions, deductions, and rate schedule. States which presently have enacted this type of tracking statute are Colorado, Delaware, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, New York, Ohio, Virginia, West Virginia, and Wisconsin.

There are several states which have taken a stance of non-conformance in the tracking movement. These states have adopted their own adjusted gross incomes, exemptions, deductions, and rate schedules. However, on selected items the states have adopted the federal treatment. These items include the child care expenses credit, the medical expenses deduction, and the energy tax credits. States with nonconforming statutes are Alabama, Arkansas, California, Mississippi, New Jersey, North Carolina, Pennsylvania, and South Carolina.

All four kinds of statutes have been analyzed by the following four criteria: (1) the effect on the taxpayer, (2) the effect on tax administrators, (3) the audit and compliance potential, and (4) the general effect of changes to federal law.

A "virtually complete" conformity tracking statute is easy for the taxpayer to understand and creates the least amount of

work for the taxpayer, as well as being the easiest kind of income tax statute to administer. While this statute has the best compliance and audit potential of any of the other statutes, it is affected largely by a change in federal income tax law.

A "substantial" conformity tracking statute is just as easy as the "virtually complete" conformity tracking statute for the taxpayer to understand and also creates little work for the taxpayer. It is easier to administer than nonconforming income tax statutes and results in good compliance and audit potential. There is a significant effect on the statute by a change in federal income tax law, but not as monumental as a "virtually complete" conformity tracking statute because the state applies its own rate schedule.

"Moderate" conformity tracking statutes are likewise easier for the taxpayer to understand and cause less work for the taxpayer than a nonconforming statute because differences at the federal and state levels in income base often cause most of the problems in nonconforming states. These statutes have better audit and compliance potential than nonconforming income tax statutes as well as being somewhat easier to administer. A change in federal income tax law has more effect on this kind of statute than on a nonconforming statute.

Nonconforming income tax statutes offer the most difficulty in taxpayer comprehension as well as the most amount of work for the taxpayer. These statutes are the most difficult to administer and have the least compliance and audit potential. However, the nonconforming income tax statute is affected very

little by federal income tax changes.

In general, the most repeated objection by tax officials in other states and by state legislators to the adoption of a tracking statute has been that such a statute ties a state's revenue collections to federal tax decisions. Since 1969 federal tax law changes have become more frequent and more substantial in nature. In addition, federal tax decisions are based not only on tax equity considerations but also on the need to slow down or stimulate the national economy as well as other policy decisions which may differ from the views of a state's citizens and state legislators. The federal income tax also is much more responsive to economic growth and inflation than is a state income tax. As the rate of inflation increases, the federal tax collections mushroom, thereby leading Congress to respond by providing major tax cuts. The feedback effect of a federal tax cut on income tax revenue in conforming states has a substantial negative effect on the usually tenuous fiscal balance in the states.

The decision was made to examine the tracking statutes in Louisiana and New York as possible models for a tracking statute in North Carolina.

The Louisiana tracking statute which was examined was a proposed tracking statute that was rejected in 1977 by the Ways and Means Committee of the Louisiana legislature as a replacement for Louisiana's present tracking statute. The proposed tracking statute would have been a method of determining income tax so that revenue collections would not be so dramatically affected by changes in the federal tax law.

The proposed Louisiana tracking statute would have the taxpayer copy the adjusted gross income from his federal return and subtract from that figure the excess itemized deductions entered on his federal return, his federal income tax liability, and any income which was included in the adjusted gross income on the federal return but which is not taxable in Louisiana. The resulting figure would be the taxable income for that taxpayer, and it would be used to enter the Louisiana tax tables to determine the Louisiana tax liability. Personal exemptions and the standard deduction would be used to build the Louisiana tax tables. Only credits allowed by the state would be used against Louisiana tax liability.

The New York tracking statute has the taxpayer copy the adjusted gross income from the federal return and then add or subtract from that figure the net amount of certain additions and subtractions. Additions represent adjustments for income items which are excluded from adjusted gross income at the federal level, but which New York has decided for various policy reasons to include in adjusted gross income, and conversely subtractions represent adjustments for income items which are included in adjusted gross income at the federal level, but which New York has decided for various policy reasons to exclude from adjusted gross income.

From the resulting figure the New York standard deduction or the amount claimed as federal itemized deductions is subtracted. The amount claimed as federal itemized deductions is adjusted by adding or subtracting the net amount of certain additions and

subtractions. In the same manner as the additions to and subtractions from federal adjusted gross income, these additions and subtractions represent respectively deductions which for various policy reasons are either allowed at the federal level, but not allowed in New York or which are not allowed at the federal level, but are allowed in New York.

From this figure the New York personal exemptions are subtracted. For taxable years beginning in 1979, the New York personal exemptions are equal to the number of federal personal exemptions claimed times seven hundred dollars ($700.00). For taxable years beginning in 1980, the New York personal exemptions are equal to the number of federal personal exemptions claimed times seven hundred and fifty dollars ($750.00).

The resulting figure is the New York taxable income to which New York tax rates are applied to determine the New York State tax liability. Only New York State tax credits are allowed against the tax liability.

The result of the examination of both of these tracking statutes was a proposed North Carolina model for a tracking statute which would use the most beneficial characteristics of both the New York statute and the proposed Louisiana statute.

The proposed North Carolina model incorporated the New York approach of adopting the federal adjusted gross income and adding or subtracting from that figure the net amount of specified additions and subtractions. As in the New York tracking statute, the additions represented adjustments for income items which are excluded from adjusted gross income at the federal level, but

which North Carolina has decided for policy reasons to include in adjusted gross income. Conversely, the subtractions represented adjustments for income items which are included in adjusted gross income at the federal level, but which North Carolina has decided for policy reasons to exclude from adjusted gross income.

From the resulting figure the standard deduction or the amount claimed as federal itemized deductions was subtracted. The standard deduction was the same amount as the federal zero bracket amount. Following the New York approach again, the amount claimed as federal itemized deductions was adjusted by adding or subtracting the net amount of various additions and subtractions. The additions and subtractions represented respectively deductions which for policy reasons are either allowed at the federal level, but not allowed in North Carolina or which are not allowed at the federal level, but are allowed in North Carolina.

The allowable North Carolina personal exemptions, as presently provided, were subtracted from the resulting figure. After this subtraction, the resulting figure was the North Carolina taxable income to which the North Carolina tax rates, as presently provided, were applied to compute the North Carolina State tax liability. Currently provided North Carolina State tax credits were allowed against the tax liability.

The advantages of adopting the proposed North Carolina model were varied. Simplification of completion of the return was seen as an advantage, unless the taxpayer was required to attach a copy of his federal return. A better potential for the State to

audit returns at a lower cost and to ensure compliance with the tax law was also viewed as an advantage. There also could be an advantageous saving in administrative costs, unless a copy of the federal return was required. Use of federal rules, regulations, and decisions was presented as an advantage in adopting the proposed North Carolina model. Other advantages included less adjustment of federal tax exchange information, elimination of listing individual items of income, such as wages and salaries, interest income, and dividends, and reduced tax liability for taxpayers who qualify for capital gains treatment.

The major advantage of adopting the proposed North Carolina model was the fact that the model was a "moderate" conformity tracking statute which would not tie the State income tax collections quite as completely to the federal income tax law, thereby not placing the State budget at the mercy of Congress.

The disadvantages of adopting the proposed North Carolina model were overwhelming. A distinct disadvantage was that there are such a substantial number of differences between the federal and State individual income tax systems that an astounding number of additions and subtractions would have to be made to federal adjusted gross income and federal itemized deductions to account for policy decisions made in North Carolina thereby negating the simplification advantage. Other disadvantages included further calculation of similar deductions and exclusions, such as the dividend deduction and medical expenses deduction, inherent difficulties in adopting a tracking statute due to the fundamental difference of federal joint filing for married

couples versus State combined filing for married couples, higher exclusions and deductions due to the larger federal tax base, and a marked shift in the tax burden among taxpayers.

The budgetary disadvantage of a reduction in federal adjusted gross income adversely affecting State revenue collections was also a paramount concern. Although the proposed model was not tied as completely to the federal income tax law, reductions in federal adjusted gross income for inflation and recessionary trends would make a severe impact on State revenue collections.

The most serious and defeating impediment to enacting the proposed North Carolina model was a probable constitutional violation. The observation had been made early in the proceedings that tax administrators in other states warned states, which were considering the possibility of adopting a tracking statute, to look at the state Constitution to determine the constitutionality of adopting the federal income tax by reference and adopting automatically any changes in federal law. Due to this observation, the Attorney General was asked to give an opinion on the following pivotal question: Does a federal individual income tax "tracking" statute, adopting the federal adjusted gross income or federal taxable income or federal tax liability, constitute an unconstitutional delegation of legislative power in contravention of Article V, Sec. 2(1) which states: "The power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away."?

The Attorney General's letter opinion concluded that if a tracking statute automatically incorporated future federal amendments, the North Carolina courts would probably find the incorporation of those amendments to be an unconstitutional delegation of legislative power in contravention of Article V, Sec. 2(1). However, the Attorney General viewed the adoption of a particular federal statute as it existed on a specified date as simply an incorporation by reference of a pre-existing statute and not a delegation of future legislative power. (See Appendix VIII).

The Attorney General explained that no state court has decided a case with the issue of constitutionality of a state law which incorporates future federal law; therefore, presented with such a case, the court would not have any North Carolina precedent on which to rely and would have to look to other states' court decisions for guidance. The problem then arises that there is no state with the combination of constitutional provisions and stringent and conservative court decisions on delegation of legislative power in administrative agency cases which North Carolina has. Therefore, other states really could not offer very much guidance to North Carolina.

The final recommendation of the Attorney General was that the Committee should proceed with caution since any attempt to adopt future federal amendments would face a very serious risk of being declared an unconstitutional delegation of legislative power.

Confrontation with the constitutional risks of adopting the

proposed North Carolina model crystallized the Committee's dilemma. Adoption of the model for the purpose of simplification in many areas would be futile unless future federal amendments could be incorporated by reference. In addition, the General Assembly itself could feel as though it was delegating its legislative power.

The Committee decided that since thirty-four states had adopted some kind of tracking statute, it would have been a dereliction of duty if the Committee had not investigated "tracking" to determine any benefits it might have for North Carolina, and that consideration of adoption of a tracking statute should be deferred at the present time.

APPENDIX I

Legislative Proposal 1

A BILL TO BE ENTITLED

AN ACT TO REMOVE THE REQUIREMENT THAT THE TAX REVIEW BOARD APPROVE REGULATIONS ISSUED BY THE SECRETARY OF REVENUE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-113.102 as the same appears in 1979 Replacement Volume 2D of the General Statutes is amended by:

(1) Adding immediately after the word "regulations" appearing in line 2 thereof the words, "and amendments thereto".

(2) Deleting the words and symbols, "such regulations to become effective when approved by the Tax Review Board. All regulations and amendments thereto shall be published and made available by the Secretary of Revenue.", appearing in lines 4, 5, 6, and 7 and inserting in lieu thereof the words and symbols, "and such regulations and amendments thereto shall be published and made available by the Secretary of Revenue. All regulations initiated by the Secretary of Revenue shall be filed in accordance with Article 5 of Chapter 150A of the General Statutes."

(3) Deleting the words, "and the regulations approved by the Tax Review Board", appearing in lines 9 and 10 thereof.

Sec. 2. G.S. 105-262 as the same appears in 1979 Replacement Volume 2D of the General Statutes is amended by:

(1) Adding immediately after the word "regulations" in line 2 the words, "and amendments thereto".

(2) Deleting the words and symbols, "such regulations to become effective when approved by the Tax Review Board. All regulations and amendments thereto shall be published and made available by the Secretary of Revenue.", appearing in lines 4, 5, 6, and 7 and inserting in lieu thereof the words and symbols, "and such regulations and amendments thereto shall be published and made available by the Secretary of Revenue. All regulations initiated by the Secretary of Revenue shall be filed in accordance with Article V of Chapter 150A of the General Statutes."

(3) Deleting the words, "and the regulations approved by the Tax Review Board", appearing in lines 9 and 10 thereof.

Sec. 3. This act shall become effective July 1, 1980. Any regulations pending before the Tax Review Board on July 1, 1980 but not yet approved under G.S. 105-113.102 or G.S. 105-262 shall be transferred to the Secretary of Revenue for further proceedings.

Legislative Proposal 2

A BILL TO BE ENTITLED

AN ACT TO ALLOW THE SECRETARY OF REVENUE DISCRETION ON REQUIRING AN AUDIT BEFORE ALLOWING A REFUND OF MOTOR FUEL TAX.

The General Assembly of North Carolina enacts:

Section 1. The last paragraph of G.S. 105-449.39 is amended to read:

"The Secretary shall not allow such refund except after an audit of the applicant's records or as provided in G.S. 105-449.40. Notwithstanding the previous sentence, if the motor carrier has complied with the provisions of this subchapter and the rules and regulations promulgated under this subchapter for a period of one full registration year, the Secretary may in his sole discretion make refunds without requiring a bond or prior audit."

Sec. 2. This act shall become effective July 1, 1980.

Legislative Proposal 3

A BILL TO BE ENTITLED

AN ACT TO CONFORM THE FEE FOR REISSUING A SALES OR USE TAX LICENSE WHEN THE LICENSE HAS BEEN SUSPENDED OR REVOKED TO THE SAME FEE AS ISSUANCE OF A NEW LICENSE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.29 is amended by deleting the words "one dollar ($1.00)", and inserting in lieu thereof the words "five dollars ($5.00)".

Sec. 2. This act shall become effective July 1, 1980.

Legislative Proposal 4

A BILL TO BE ENTITLED

AN ACT TO RAISE THE MINIMUM TAX THRESHOLD FOR PAYMENT OF INTANGIBLES TAX TO REFLECT INFLATION SINCE 1963, SO AS TO REDUCE THE NUMBER OF PERSONS LIABLE FOR INTANGIBLES TAX.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-214 is amended by deleting the words "five dollars ($5.00)" and inserting in lieu thereof "fifteen dollars ($15.00)".

Sec. 2. This act shall become effective with respect to taxable years beginning on and after January 1, 1980.

Legislative Proposal 5

A BILL TO BE ENTITLED

AN ACT TO ALLOW NONRESIDENTS, FILING NORTH CAROLINA RETURNS, TO APPORTION PERSONAL DEDUCTIONS BETWEEN NORTH CAROLINA AND THEIR STATES OF PRINCIPAL RESIDENCE TO THE EXTENT THAT THEIR STATES OF PRINCIPAL RESIDENCE ALLOW APPORTIONMENT OF PERSONAL DEDUCTIONS BY NONRESIDENTS FILING RETURNS IN THAT STATE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-147(18) is rewritten to read as follows:

"In the case of a nonresident individual or partnership, the deductions allowed in this section other than deductions connected with income arising from sources within the State shall be allowed only in the proportion that the individual's adjusted gross income reportable to North Carolina relates to his total adjusted gross income, if the nonresident's state of principal residence allows similar apportionment of personal deductions. The proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules prescribed by the Secretary of Revenue."

Sec. 2. G.S. 105-147(22) is amended to delete the last sentence which reads as follows:

"Provided, further, that the provisions of this subdivision shall not apply to taxpayers who are not residents of this State."

Sec. 3. This act is effective with respect to taxable years beginning on and after January 1, 1980.

Legislative Proposal 6

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE SALES TAX EXEMPTION FOR CERTAIN EXPORTS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.13(33), as it appears in 1979 Replacement Volume 2D of the General Statutes is rewritten to read:

"(33) Tangible personal property purchased solely for the purpose of export to a foreign country for exclusive use or consumption in that or some other foreign country, either in the direct performance or rendition of professional or commercial services, or in the direct conduct or operation of a trade or business, all of which purposes are actually consummated, or purchased by the government of a foreign country for export which purpose is actually consummated. 'Export' shall include the acts of possessing and marshalling such property, by either the seller or the purchaser, for transportation to a foreign country, but shall not include devoting such property to any other use in North Carolina or the United States. 'Foreign country' shall not include any territory or possession of the United States.

In order to qualify for this exemption, an affidavit of export indicating compliance with the terms and conditions of this exemption, as prescribed by the Secretary of Revenue, must be submitted by the purchaser to the seller, and retained by the seller to evidence qualification for the exemption.

If the purposes qualifying the property for exemption are not consummated, the purchaser shall be liable for the tax which was avoided by the execution of the aforesaid affidavit as well as for applicable penalties and interest and the affidavit shall contain express provision that the purchaser has recognized and assumed such liability.

The principal purpose of this exemption is to encourage the flow of commerce through North Carolina ports that is now moving through out-of-State ports. However, it is not intended that property acquired for personal use or consumption by the purchaser, including gifts, shall be exempt hereunder."

Sec. 2. This act shall become effective October 1, 1980 but shall not affect any transaction before such date.

Legislative Proposal 7

A BILL TO BE ENTITLED

AN ACT TO PROVIDE THAT CREDIT ON THE NORTH CAROLINA USE TAX FOR SALES TAX PAID IN ANOTHER STATE SHALL BE GIVEN ONLY ON A RECIPROCAL BASIS, AND TO MAKE A SIMILAR AMENDMENT AS TO LOCAL GOVERNMENT USE TAXES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.6(4) is amended by adding at the end the following new language: "No credit shall be given under this sub-division for sales or use taxes paid in another state if that state does not grant similar credit for sales taxes paid in North Carolina."

Sec. 2. G.S. 105-468 is amended by adding at the end the following new language: "No credit shall be given under this section for sales or use taxes paid in a taxing jurisdiction outside this state if that taxing jurisdiction does not grant similar credit for sales taxes paid under this Article."

Sec. 3. Section 5 of Chapter 1096, Session Laws of 1967 is amended by adding at the end the following: "No credit shall be given under this section for sales and use taxes paid in a taxing jurisdiction outside this state if that taxing jurisdiction does not grant similar credit for sales taxes paid under this section."

Sec. 4. This act shall become effective July 1, 1981.

Legislative Proposal 8

A BILL TO BE ENTITLED

AN ACT TO PROVIDE THAT A PRIME CONTRACTOR IS JOINTLY LIABLE WITH A SUBCONTRACTOR FOR USE TAX UNLESS THE SUBCONTRACTOR'S AFFIDAVIT THAT THE TAX HAS BEEN PAID IS FURNISHED TO THE CONTRACTOR.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.6(3) is amended by deleting the following language: "Provided, however, the taxes levied in this section shall be levied against the purchaser of the articles named. If purchases of building materials that are not exempt from tax are made by a contractor there shall be joint liability for the tax against both contractor and owner, but the liability of the owner shall be satisfied if affidavit is required of the contractor, and furnished by him, before final settlement is made, showing that the tax herein levied has been paid in full.", and inserting in lieu thereof the following new language: "Said tax shall be levied against the purchaser of such property. Provided, that where the purchaser is a contractor, the contractor and owner shall be jointly and severally liable for said tax, but the liability of the owner shall be deemed satisfied if before final settlement between them the contractor furnishes to the owner an affidavit certifying that said tax has been paid. Provided further, that where the purchaser is a subcontractor, the

contractor and subcontractor shall be jointly and severally liable for said tax, but the liability of the contractor shall be deemed satisfied if before final settlement between them the subcontractor furnishes to the contractor an affidavit certifying that said tax has been paid."

Sec. 2. This act shall become effective October 1, 1980.

Legislative Proposal 9

A BILL TO BE ENTITLED

AN ACT TO ALLOW GARNISHEES TO RESPOND TO NOTICES OF GARNISHMENT UNDER THE REVENUE ACT AND THE MACHINERY ACT BY CERTIFIED AS WELL AS REGISTERED MAIL.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-242(b) as the same appears in Replacement Volume 2D of the 1979 General Statutes is amended in lines 39 and 47 by in each place deleting the word "registered" and inserting in lieu thereof in each place the word "registered or certified".

Sec. 2. G.S. 105-368(c) and G.S. 105-368(d) are each amended by deleting the word "registered" and inserting in lieu thereof in each place the words "registered or certified".

Sec. 3. This act shall become effective October 1, 1980.

Legislative Proposal 10

A BILL TO BE ENTITLED

AN ACT TO APPROPRIATE FUNDS TO THE LEGISLATIVE RESEARCH COMMISSION FOR FURTHER STUDY BY THE REVENUE LAWS STUDY COMMITTEE.

Whereas, the Legislative Research Commission was directed by the 1979 General Assembly in ratified Resolution 83 to continue the study of the revenue laws of North Carolina; and

Whereas, pursuant to Resolution 83 a Committee on Revenue Laws was appointed and held six meetings before reporting its recommendations to the Legislative Research Commission and the 1979 General Assembly, Second Session; and

Whereas, the Committee on Revenue Laws examined various problem areas in the revenue laws and recommended legislation making either technical revisions or substantive changes in the sales and use tax, intangibles tax, individual income tax, property tax, and gasoline tax; and

Whereas, there remain areas in the revenue laws which need further review; and

Whereas, the time and budget limits placed on the Committee did not allow further investigation of those areas; Now, therefore,

The General Assembly of North Carolina enacts:

Section 1. There is appropriated from the General Fund the sum of eight thousand dollars ($8,000) for the 1980-81

fiscal year to the Legislative Research Commission for further study of the revenue laws by the Committee on Revenue Laws.

Sec. 2. This act shall become effective July 1, 1980.

Legislative Proposal 11

A BILL TO BE ENTITLED

AN ACT TO EXEMPT FROM AD VALOREM TAXATION PERSONAL PROPERTY SHIPPED INTO THIS STATE FOR REPAIR AND THEN RESHIPPED TO THE OWNER OUTSIDE THIS STATE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-275 is amended to add a new subsection to read as follows:

"(25) Tangible personal property shipped into this state and held at a business premise, other than that of the owner, for the purpose of repair, alteration, maintenance or servicing and reshipment to the owner outside this state. This classification shall not include raw materials, supplies, or goods in process of manufacture in this state."

Sec. 2. This act shall become effective January 1, 1981.

Legislative Proposal 12

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE SALES TAX ON LABOR SERVICE CHARGES AT ESTABLISHMENTS SERVING FOOD, BEVERAGES, OR MEALS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.13A is rewritten to read:

"§105-164.13A. Service charges on food, beverages, or meals. When a service charge is imposed on food, beverages, or meals, so much of said service charge as does not exceed 15% of the sales price is specifically exempted from the tax imposed by this article when the service charge:

(1) is separately stated in the price list, menu, or written proposal and also in the invoice or bill; and

(2) is turned over to the personnel directly involved in the service of the food, beverages, or meals, in accordance with G.S. 95-25.6. Such service charge shall be considered to be a tip."

Sec. 2. This act shall become effective October 1, 1980.

Legislative Proposal 13

A BILL TO BE ENTITLED

AN ACT TO AMEND G.S. 105-141 TO PROVIDE FOR INDIVIDUALS AN INCOME TAX EXCLUSION ON INTEREST RECEIVED ON SAVINGS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-141 is amended to add at the end of subsection (b) a subdivision (28) to read as follows:

"(28) Interest received, not to exceed two hundred dollars ($200.00), from savings deposits or certificates evidencing savings deposits in banks, credit unions, and savings and loan associations located within the State of North Carolina."

Sec. 2. This act is effective upon ratification and shall apply to taxable years beginning on or after January 1, 1980.

Legislative Proposal 14

A BILL TO BE ENTITLED

AN ACT TO PROVIDE THAT REPORTS ON SPECIAL FUEL TAX AND REPORTS AND TAX ON OUT-OF-STATE FUEL SHALL BE DUE ON THE SAME DATE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-449.10 is amended by deleting the words "the twenty-fifth day" and inserting in lieu thereof the words "the last day".

Sec. 2. G.S. 105-449.42 and G.S. 105-449.45 are amended by deleting the words "the twentieth day" and inserting in lieu thereof the words "the last day".

Sec. 3. This act shall become effective October 1, 1980.

Legislative Proposal 15

A BILL TO BE ENTITLED

AN ACT TO PROVIDE FOR THE ACCRUAL OF INTEREST UPON DOCKETED CERTIFICATES OF TAX LIABILITY AT THE RATE ESTABLISHED UNDER G.S. 105-241.1(i).

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-242(c) is hereby amended by rewriting the first sentence of the third paragraph, beginning with "A certificate" and ending with "docketing," to read as follows:

"A certificate or judgment in favor of the State or the Secretary of Revenue for taxes payable to the Department of Revenue shall be valid and enforceable for a period of 10 years from the date of docketing and shall bear interest from and after the date of docketing at the rate established under G.S. 105-241.1(i)."

Sec. 2. This act shall become effective July 1, 1980, but shall not apply to interest accruing before such date.

APPENDIX II

Fiscal Research Division
Report on Proposal 1

Explanation of Proposal:

Amends G.S. 105-262 to eliminate the requirement that the Tax Review Board approve Department of Revenue regulations. Effective July 1, 1980.

Fiscal Effect:

Insignificant effect on General Fund. Should reduce amount of time spent in meetings and/or number of meetings. Members receive per di expenses from General Fund.

Comments:

(1) The Board consists of the State Treasurer, Chairman of Utilities Commission, a gubernatorial appointee, and the Secretary of Revenue (who does not vote on proposed Revenue Department regulations.)

(2) The provision requiring Board approval of the regulations was enacted in 1955. Prior to that time the Department did not nee outside approval to promulgate the regulations.

(3) The Administrative Procedures Act exempts the Department from holding public hearings on the proposed regulations. However, the Superior Court can hear appeals from regulations and the APA requires that the rules be filed with the Attorney General. Also the regulations are to be reviewed by the Administrative Rules Review Committee of the Legislative Research Committee.

Fiscal Research Division
Report on Proposal 2

Explanation of Proposal:

Amends provision in current motor fuel tax law requiring annual Revenue Department audits of firms requesting tax refunds by giving Secretary of Revenue discretionary authority to make audit. Effective July 1, 1980.

Fiscal Effect:

Insignificant effect on Highway Fund net collections. Will require less audits. In many cases cost of audit exceeds amount of refund.

Comments:

Statute of limitations allows Department of Revenue to go back three years if a problem were discovered with a refundee.

Fiscal Research Division
Report on Proposal 3

Explanation of Proposal:

Increases the fee for the re-issue of a suspended or revoked sales and use tax license from $1 to $5, effective July 1, 1980.

Fiscal Effect:

Would lead to a small increase in General Fund tax revenue.

Comments:

The 1979 Session enacted the 1978 Revenue Laws Study Committee recommendation of such a fee increase for the issuance of a new license but overlooked the re-issuance fee.

March 24, 1980

Fiscal Research Division
Report on Proposal 4

Explanation of Proposal:

Increases the filing threshold under the intangibles tax from $5 to $15, effective January 1, 1980.

Fiscal Effect:

Would reduce General Fund tax revenue by $468,000 per year, starting with 1980-81. This amount is less than 1% of projected intangibles tax revenue for 1980-81. Approximately 40,480 intangibles tax returns, or 22% of the total number (190,000) would be eliminated.

Comments:

(1) The tax returns filed are those in which the taxpayer has stocks, bonds, accounts receivable, or other items taxed at 25¢ per $100. The tax on money on deposit is collected by banks.

(2) The increase in the threshold is equivalent to a full exemption for taxpayers owning less than $6,000 of stocks or bonds, versus the current law equivalent of $2,000.

(3) The $5 threshold was enacted in 1963. Adjusting the threshold for inflation through January, 1981, would lead to a $15 threshold.

(4) The proposal should "free-up" departmental auditors and returns processors to devote their time to the larger returns.

JAMES B. HUNT, JR.
GOVERNOR

MARK G. LYNCH
SECRETARY

JAMES P.
DEPUTY SE

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
P. O. BOX 25000
RALEIGH, N. C. 27640
January 2, 1980

MEMORANDUM

TO: B. W. Brown, Director, Individual Income Tax Division

FROM: B. E. Dail, Assistant Director, Tax Research Division BED

SUBJECT: Revision of estimate of revenue loss that would arise from allowing non-residents to claim personal deductions

This is in response to your telephone request for a revision of our estimate made last year regarding the revenue loss that would arise if non-residents were allowed to claim personal deductions. The estimate has been revised to reflect the change in South Carolina's income tax law, made effective for income years starting on or after January 1, 1980, which provides that non-residents may not claim personal deductions unless their state of residence allows South Carolina residents to claim personal deductions when filing as non-residents in such state.

The original estimate of revenue loss was $1,525,000. The revised estimate is $1,025,000. The lower estimate takes into account the fact that North Carolina residents will presumably claim larger tax credits for tax paid to South Carolina for 1980 and subsequent years because they will no longer be able to claim personal deductions in determining their South Carolina tax liability. If North Carolina changes its law to allow non-residents to claim personal deductions, there would be an increase in our revenue from North Carolina taxpayers filing with South Carolina since the tax credits claimed on their North Carolina returns would be smaller. Of course, as the two estimates indicate, this revenue increase would be only a partial offset to the revenue los arising from non-residents claiming personal deductions.

BED:cw

March 25, 1980

Fiscal Research Division
Report on Proposal 6

Explanation of Proposal:

Clarifies the 1979 Session legislation that exempted from the sales and use tax goods purchased, in the State for use in a foreign country, in cases where the buyer takes delivery in North Carolina. Under the proposal goods for "personal use" would not be eligible for the exemption.

Fiscal Effect:

Insignificant increase in General Fund tax revenue.

Comments:

(1) Under various N. C. Supreme Court decisions, goods shipped directly overseas by North Carolina merchants or manufacturers have always been exempt.
(2) The proposal has been studied by the Attorney General's Office, the Department of Revenue, the State Ports Authority, and the bill-drafting staff of the General Assembly. All parties are satisfied that the proposal clears up the loophole in the current law and carries out the intent of the 1979 General Assembly.

March 28, 1980

Fiscal Research Division
Report on Proposal 7

Explanation of Proposal:

Under the present State sales and use tax law, a use tax credit is allowed for any sales tax paid to another state. In South Carolina and West Virginia such a credit is not allowed so that a contractor buying materials in North Carolina for use on a job in South Carolina would not receive a South Carolina use tax credit for the sales tax paid to North Carolina (where delivery is made in North Carolina or contractor picks up materials in North Carolina). The proposal would amend the North Carolina law to allow a state use tax credit only against the sales tax paid to those states that have a reciprocal use tax credit. The proposal is effective July 1, 1981. Thus, a South Carolina contractor purchasing items in South Carolina for a North Carolina job would not receive a North Carolina use tax credit against the South Carolina sales tax.

Fiscal Effect:

Would increase General Fund tax revenue slightly. If the South Carolina contractor continues buying and taking delivery in South Carolina for a North Carolina job, the removal of the North Carolina credit will lead to more sales tax revenue for North Carolina at the expense of the contractor. South Carolina will still get the sales tax revenue. If the contractor takes delivery in North Carolina or purchases the materials in North Carolina, North Carolina will gain sales tax revenue at the expense of South Carolina and the taxpayer's liability will not increase.

Comments:

(1) The proposal grew out of a long-standing dispute between North Carolina and South Carolina over differing treatment under various tax laws. Until this year South Carolina, along with practically all other states with an income tax, allowed non-resident taxpayers a prorated share of itemized deductions while North Carolina does not allow such a proration. Thus, South Carolina residents working in North Carolina cannot receive any portion of itemized deductions against the North Carolina personal income tax. Legislation was considered in 1977, 1978, and 1979 to allow out-of-state residents a prorated share of these deductions (at a revenue loss to North Carolina of $1.5 million) but the legislation received a low-priority relative to other tax bills. This led South Carolina to retaliate in 1979 by changing its income tax law to disallow itemized deductions to non-residents if their state of residency did not allow such a proration. Thus, North Carolinians working in South Carolina no longer receive any South Carolina itemized deductions.

The July, 1981 effective date was designed to give the 1981 session of the South Carolina legislature a chance to amend its sales tax law. At the same time the Revenue Laws Committee here in North Carolina has recommended an amendment to our income tax law to allow a proration of itemized deductions for non-residents.

(2) Twelve (12) other states have also retaliated against South Carolina and West Virginia regarding the use tax credit. The proposed bill is patterned after Kentucky and Alabama legislation.

Fiscal Research Division
Report on Proposal 8

Explanation of Proposal:

Clarifies the sales and use tax law regarding the liability of owners, contractors, and subcontractors for the use tax on materials that become part of the finished product, effective October 1, 1980. Under the present law a use tax is levied against such property and there is a joint liability between the contractor and owner but the liability of the owner may be satisfied if an affadavit is provided by the contractor showing that the contractor has paid the tax in full. Even though the Secretary of Revenue has the authority to assess the owner, the contractor or subcontractor is technically liable for the use tax as purchasers of the materials. Also, it is possible that the contractors and subcontractors have performed more than one contract in North Carolina and are liable for the use tax on all purchases used in the performance of the contracts. The records of the property owner may not completely reflect all the subcontractors who do the work, even if the owner has obtained the prescribed affadavit from the general contractor. In this case, the Revenue Department has no indication of whether the tax has been paid.

The proposed bill would require general contractors to obtain affadavits from subcontractors, or, in the absence of such an affadavit, would make the general contractor liable for the tax for purchases by the subcontractor. The reason for the general contractor's liability is that, in effect, he has obtained the materials through the subcontractor, until evidence is presented that the subcontractor paid the tax. Until the property owner has such an affadavit, the owner and the general contractor are liable for the tax.

Fiscal Effect:

None since the tax is currently being paid by one of the parties.

March 25, 1980

Fiscal Research Division
Report on Proposal 9

Explanation of Proposal:

Amends the garnishment sections of the Revenue Act and the Machinery Act to allow the garnishee to send garnishment notices by certified mail as well as registered mail.

Fiscal Effect:

Would reduce the garnishee's cost of mailing from $3.15 to $.95 with no significant effect on state.

Comments:

Fiscal Research Division
Report on Proposal 11

Explanation of Proposal:

Under present property tax law, tangible personal property shipped into the State for repair and then reshipped to the owner outside the state would be exempt from each county's property tax base because the property is not permanently located in the state and therefore does not have tax situs in the state. The bill would make it clear that such property is exempt by adding an exemption for such property to the present list of property tax exemptions. The bill would become effective January 1, 1981.

Fiscal Effect:

No effect as property is already exempt.

Comments:

(1) The need for the exemption has arisen from the fact that tax supervisors in some counties have attempted to assess such property.

Fiscal Research Division
Report on Proposal 12

Explanation of Proposal:

Prior to the 1979 Session of the General Assembly the Sales Tax Division of the N. C. Department of Revenue had been interpreting the sales tax law (through Sales Tax Ruling 71) to apply the 3% state sales tax to service charges on prearranged group meals. Voluntary tips have always been exempt from the tax. Section 76 of Chapter 801 of the 1979 Session Laws allowed an exemption for these charges. The legislation defined a "service charge" as a "prearranged charge, not to exceed fifteen percent (15%), agreed to by the contracting parties, which represents labor charges for serving meals". The term "prearranged group meals" was defined to include meals for four or more people, for which the price had been agreed upon in advance.

The Revenue Department has interpreted the 1979 law according to the fairly tight definitional guidelines and a couple of Attorney General opinions have supported their interpretations. As a result, there are three types of "meals" in which the service charge has not been allowed to be exempt from the tax:

1. stand-up receptions;
2. group meals where a service charge is agreed to when the party gets to the restaurant; and
3. meals at country club facilities

The bill would extend the exemption to these cases by

1. removing the "pre-arrangement" requirement,
2. removing the four-person group-size minimum requirement,
3. removing the restriction as to the type of dining facility to which the exemption applies, and
4. including food and beverages in the coverage

The bill does state that the service charge must be set out separately in the menu and in the bill for the meal and that the service charge must be turned over to the personnel directly involved in meal preparations and services. The bill would be effective October 1, 1980.

Fiscal Effect:
Would have a minimal impact on General Fund tax revenue.

Legislative Proposal 13

JAMES B. HUNT, JR
GOVERNOR

MARK G. LYNCH
SECRETARY

JAMES P SENTER
DEPUTY SECRETARY

State of North Carolina
Department of Revenue
P. O. Box 25000
Raleigh, N. C. 27640

April 18, 1980

Mr. David F. Crotts
Legislative Services Office
Legislative Building
Raleigh, North Carolina

Dear Mr. Crotts:

In compliance with your request of April 11, 1980, we are indicating below the revenue loss in the event that legislation is enacted excluding $200 and $400 per taxpayer of interest received from savings deposits, or CDs in banks, credit unions and savings and loan associations located in North Carolina. The computations are for the interest received during the 1980 calendar year. It is likely that inquiries will be made regarding the exclusion per taxpayer of $200 and $400 of interest received from all sources, as well as interest received from banks, savings and loan associations, and credit unions, regardless of where located. Consequently, we are indicating the revenue loss in such cases.

	$200 Exemption	$400 Exemption
A. Exempt indicated amount of interest paid by banks, savings and loan associations, and credit unions located in North Carolina	$6,000,000	$8,400,000
B. Exempt indicated amount of interest paid by banks, savings and loan associations, and credit unions	6,400,000	8,800,000
C. Exempt indicated amount of all interest	6,700,000	9,300,000

Sincerely,

Mark G. Lynch

Mark G. Lynch, Secretary

MGL:il

cc: Ms. Desiree White

Fiscal Research Division
Report on Proposal 14

Explanation of Proposals:

Under the present special fuels tax law motor carriers are required to file two special reports:

(a) A Special Fuels Report, due on the 25th of the month following the close of a calendar quarter. This report is informational in nature and reflects vendor's names, place of purchase, and gallons of fuel purchased during the preceding calendar quarter. The report is used by the Revenue Department for audit purposes.

(b) A Highway Fuel Use Tax Report, due on the 20th of the month following the end of a calendar quarter. With this report the motor carriers remit tax on motor fuels used in their operations within North Carolina.

The proposal would change the due date of both reports to the last day of the month following the end of a calendar quarter. The proposal would be effective July 1, 1980.

Fiscal Effect:

No effect.

Fiscal Research Division Comments:

The proposal would satisfy the motor carrier industry and would ease their administrative burden.

Fiscal Research Division
Report on Proposal 15

Explanation of Proposal:
Amends the tax law dealing with assessments to allow assessments to continue to bear interest at a rate of 12%, instead of 6%, after the assessments have been docketed. Effective July 1, 1980.

Fiscal Effect:
No data available with which estimate could be made.

APPENDIX III

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1979
RATIFIED BILL

RESOLUTION 83

SENATE JOINT RESOLUTION 94

A JOINT RESOLUTION DIRECTING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF THE STATE OF NORTH CAROLINA.

Whereas, the Legislative Research Commission was directed by the 1977 General Assembly in ratified Resolution 85 to conduct a study of the revenue laws of North Carolina; and

Whereas, pursuant to Resolution 85 a Committee on Revenue Laws was appointed and held 11 meetings before reporting its recommendations to the Legislative Research Commission and the 1979 General Assembly; and

Whereas, the Committee on Revenue Laws reviewed many areas of the revenue laws and prepared more than 40 legislative proposals to modernize, improve, and delete obsolete sections from the revenue laws; and

Whereas, the scope of the subject matter assigned to the Committee on Revenue Laws was so broad that not all areas could be addressed within the time and budget limits placed on the Committee; and

Whereas, in the course of its deliberations the Committee on Revenue Laws discovered several matters which warranted further investigation; and

Whereas, changes in federal tax laws often make review of related State laws advisable; and

Whereas, the Committee on Revenue Laws has proved to be an excellent forum to which both taxpayers and State officials can turn with problems and complaints about the revenue laws; Now, therefore, be it resolved by the Senate, the House of Representatives concurring:

Section 1. The Legislative Research Commission shall continue to study the revenue laws and their administration in North Carolina.

Sec. 2. The commission shall continue to review the revenue laws of the State of North Carolina to determine which laws need clarification, technical amendment, repeal, or other change to make the revenue laws as concise, intelligible, administratively responsive, and efficient as is reasonably practicable. Where the recommendations of the Commission, if enacted, would result in an increase or decrease in State tax revenues, the final report of the Commission shall include an estimate of the amount of such increase or decrease.

Sec. 3. The Commission may call upon the Department of Revenue to cooperate with it in its study, and the Secretary of Revenue shall insure that its employees and staff provide full and timely assistance to the Commission in the performance of its duties.

Sec. 4. The Commission shall produce a final report with its recommendations for improvement of the revenue laws to the 1981 General Assembly and may produce an interim report to the 1979 General Assembly, Second Session 1980.

Sec. 5. This resolution is effective upon ratification.

In the General Assembly read three times and ratified, this the 8th day of June, 1979.

JAMES C. GREEN

James C. Green

President of the Senate

CARL J. STEWART, JR.

Carl J. Stewart, Jr.

Speaker of the House of Representatives

1979 - 81

LEGISLATIVE RESEARCH COMMISSION MEMBERSHIP

House Speaker Carl J. Stewart, Jr. Co-Chairman	Senate President Pro Tempore W. Craig Lawing, Co-Chairman
Representative Chris S. Barker, Jr.	Senator Henson P. Barnes
Representative John R. Gamble, Jr.	Senator Melvin Daniels, Jr.
Representative H. Parks Helms	Senator Carolyn Mathis
Representative John J. Hunt	Senator R. C. Soles, Jr.
Representative Lura S. Tally	Senator Charles Vickery

LEGISLATIVE RESEARCH COMMISSION

Committee on

Revenue Laws

	Telephone
Senator Carolyn Mathis, LRC Member Post Office Box 30035, Charlotte, North Carolina 28230	704-554-6535

Subcommittee A

Representative Daniel T. Lilley, Chairman Post Office Box 824 Kinston, North Carolina 28501	919-523-4309
Senator T. Cass Ballenger Post Office Box 2029 Hickory, North Carolina 28601	704-328-2466
Senator Larry B. Leake 55 Westall Avenue Asheville, North Carolina 28804	704-253-3661
Mr. Richard E. Thigpen 3500 NCNB Plaza Charlotte, North Carolina 28280	704-373-1300
Mr. David Ward Post Office Box 867 New Bern, North Carolina 28560	919-633-1000

Subcommittee B

Senator Marshall Rauch, Chairman Rauch Industries, Inc. Post Office Box 609 Gastonia, North Carolina 28052	704-867-5000
Senator Jack Childers 16 West First Avenue Lexington, North Carolina 27292	704-249-0622
Mr. Edward Clark Peat, Marwick, Mitchell and Company Post Office Box 18768 Raleigh, North Carolina 27609	919-782-6600

Mr. Robert F. Clodfelter 919-748-5271
570 Westover Avenue
Winston-Salem, North Carolina 27103

Mr. Linwood Davis 919-725-1311
Womble, Carlyle, Sandridge, and Rice
2400 Wachovia Building
Winston-Salem, North Carolina 27101

Mr. Robert H. Merritt, Jr. 919-781-6400
Post Office Box 709
Raleigh, North Carolina 27602

APPENDIX IV

LEGISLATIVE RESEARCH COMMISSION

Committee on

REVENUE LAWS

SUBCOMMITTEE A: ASSIGNED TOPICS OF STUDY

Tax Incentives for Gasoline Alternatives

Gasoline Tax

Sales and Use Tax

Intangibles Tax

Property Tax

License Tax

Excise Tax

SUBCOMMITTEE B: ASSIGNED TOPICS OF STUDY

Corporate and Individual Income Tax

Inheritance Tax

Reciprocal Individual Income Tax Deductions for Nonresidents

Tax Incentives for Resident Companies

Conforming Changes in State Tax Law Based on Changes in the Federal Tax Law

Taxation of Tenancy by the Entirety

APPENDIX V

Witnesses Appearing Before the

Legislative Research Commission

Committee on

Revenue Laws

Personnel from the Department of Revenue
who Assisted the Committee

Mr. R. E. Beck
Director, Gasoline Tax Division

Mr. B. W. Brown
Director, Individual Income Tax Division

Mr. Keith Goodson
Assistant Secretary of Revenue

Mr. Eric L. Gooch
Director, License and Excise Tax Division

Mr. Frank S. Goodrum, Jr.
Director, Intangibles Tax Division

Mr. D. R. Holbrook
Director, Ad Valorem Tax Division

Mr. Mark Lynch
Secretary of Revenue

Mr. B. E. Rogers
Director, Inheritance and Gift Tax Division

Mr. Larry D. Rogers
Director, License and Excise Tax Division

Mr. James Senter
Deputy Secretary of Revenue

Mr. H. C. Stansbury
Director, Tax Research Division

Persons Appearing Before the Committee

Mr. David Crotts
Senior Fiscal Analyst
Fiscal Research Division

Ms. Edith Marsh
Government Relations Administrator
Westinghouse Electric Corporation

Mr. Michael Olson
Executive Director
North Carolina Innkeepers Association

Ms. Marilyn Rich
Assistant Attorney General
North Carolina Department of Justice

Mr. Ray Sparrow
Chairman
North Carolina Savings and Loan Commission

Mr. Paul Stock
Staff Attorney
North Carolina Savings and Loan League

Mr. Jerry Williams
Executive Director
North Carolina Restaurant Association

APPENDIX VI

Persons Appearing Before the Committee

Mr. David Crotts
Senior Fiscal Analyst
Fiscal Research Division

Ms. Edith Marsh
Government Relations Administrator
Westinghouse Electric Corporation

Mr. Michael Olson
Executive Director
North Carolina Innkeepers Association

Ms. Marilyn Rich
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North Carolina Department of Justice

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Chairman
North Carolina Savings and Loan Commission

Mr. Paul Stock
Staff Attorney
North Carolina Savings and Loan League

Mr. Jerry Williams
Executive Director
North Carolina Restaurant Association

APPENDIX VI

State of North Carolina
Department of the Treasurer

HARLAN E. BOYLES
STATE TREASURER

325 N. SALISBURY STREET
RALEIGH, NORTH CAROLINA 27611

February 29, 1980

Revenue Laws Study Commission
Legislative Research Commission
General Assembly of North Carolina
Raleigh, North Carolina 27611

Attention: Gerry Cohen

Dear Sirs:

Under current provisions of the Revenue Act, the regulations of the Secretary of Revenue require approval of the Tax Review Board.

As Chairman of the Tax Review Board, I see no objections to removing the provision requiring the Board's approval in view of other provisions in the Administrative Procedures Act, which in many instances duplicate the proceedings of the Tax Review Board and the Secretary of Revenue.

If we can be of further assistance, please advise.

Sincerely,

Harlan E. Boyles

Harlan E. Boyles
State Treasurer

HEB/fms

cc: The Honorable Mark G. Lynch
Mr. H. C. Stansbury

APPENDIX VII

James B. Hunt, Jr
Governor

D. M. Faircloth, Secretary
(919) 733-4962

NORTH CAROLINA
DEPARTMENT
OF COMMERCE

March 11, 1980

Senator Marshall A. Rauch
Representative Daniel T. Lilley
Co-Chairmen
Committee on Revenue Laws
Legislative Building
Raleigh, North Carolina 27611

Dear Marshall and Dan:

On behalf of the State Ports Authority and my department, I wish to attest to our support of the proposed revisionary draft for the sales tax exemption for exports (G.S. 105-164.13(32).

In the original legislation in 1979 it certainly was not our intention to open a "loophole" to allow for the purchase of personal items without the payment of sales tax. However, the law as enacted in 1979 is serving us well and will have far greater impact for commerce through our ports as the major construction and other development activities get underway in the developing countries. The proposed revision will maintain the integrity of the 1979 law and yet close the unintended loophole.

If there are questions or if my staff can serve you in any further way, please call.

Sincerely,

D. M. Faircloth

DMF:mbs
cc: Mr. Jerry Cohen
Legislative Counsel

430 N. Salisbury St., Raleigh, N.C. 27611

APPENDIX VIII

State of North Carolina
Department of Justice
P. O. Box 629
Raleigh
27602

FUS L. EDMISTEN
TTORNEY GENERAL

18 February 1980

Senator Marshall A. Rauch
State of North Carolina
Legislative Research Commission
State Legislative Building
Raleigh, North Carolina 27611

Re: Individual Income Tax; Constitutionality of Tracking Statutes

Dear Senator Rauch:

In response to your recent letter inquiring as to the constitutionality of state individual income tax "tracking" statutes, I am enclosing a copy of a memorandum from this office to Mr. Hudson C. Stansbury, Director of the Tax Research Division of the Department of Revenue.

The memorandum deals primarily with the subject of incorporation of future federal amendments (your question #3) and concludes that the North Carolina courts would probably find the incorporation of such amendments to be an impermissible delegation of legislative power. However, as the memorandum further states, the adoption of a particular federal statute as it existed on a specified date would be simply incorporation by reference of a pre-existing statute and not a delegation of power to be exercised in the future. This point, I believe, relates to your first question.

Article V, Section 2(2) of the North Carolina Constitution, cited in your second question, relates to ad valorem taxation. Even if it were applicable to income taxation, there would be no lack of uniformity since a state statute incorporating a federal statute would affect all North Carolina taxpayers equally.

Your last question concerning waiver of sovereignty appears to me to raise the same issue as your first question concerning delegation of power.

If I can be of further assistance, please feel free to contact me at any time.

Yours very truly,

RUFUS L. EDMISTEN
Attorney General

Marilyn R. Rich
Assistant Attorney General

MRR:ceh
Enclosure

18 August 1977

MEMORANDUM

TO: Mr. Hudson Stansbury, Director
Tax Research Division

FROM: Marilyn R. Rich
Associate Attorney General

RE: Constitutionality of a North Carolina individual income tax statute based on the Internal Revenue Code, including future amendments.

A North Carolina statute adopting by reference future amendments to the Internal Revenue Code would be subject to attack as an unconstitutional delegation of legislative power to the Congress. The relevant provision of the North Carolina Constitution is Article V §2, which reads as follows: "The power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall or never be surrendered, suspended or contracted away".

No court of this State has been called upon to decide the constitutionality of a state law which incorporates future federal law. Consequently, if such a statute were enacted and its constitutionality litigated, the court would have no North Carolina precedent to rely upon and would have to turn to authorities from other states.

Of the 43 states which impose a state individual income tax, eleven make no reference to federal law. An additional twelve states incorporate portions of the Internal Revenue Code as it existed on a specified date, just as North Carolina does in the case of corporate income tax. These, of course, pose no constitutional problem. Four of the remaining twenty-one states define various terms by reference to the Internal Revenue Code, but they neither mention future amendments nor limit the Code references by specifying a particular date. The remaining seventeen expressly adopt future code amendments, frequently using language similar to the following Delaware statute:

"Any term used in this chapter shall
have the same meaning as when used

> in a comparable context in the laws of the United States referring to federal income taxes, unless a different meaning is required. Any reference to the laws of the United States shall mean the provisions of the Internal Revenue Code of 1954 (26 U.S.C.A. §1 et seq.) and amendments thereto and other laws of the United States relating to federal income taxes, as the same may be or become effective, for the taxable year."
> 30 Del. Code Ann. §1101

Only three states - Missouri, New York and Colorado - have constitutional provisions authorizing the adoption of future federal law by reference. By definition, the issue of constitutionality cannot arise in those states. It appears, then, that 18 states have, without specific constitutional authority, enacted laws which adopt future federal amendments by reference. Only two have acknowledged the risk of unconstitutionality. The laws of Virginia and Rhode Island provide that they are to be construed as adopting the Internal Revenue Code as it existed on a specified date if the adoption of future federal law is found to be unconstitutional.

Considering the large number of states which have enacted tax legislation incorporating future federal law, there has been surprisingly little litigation on the issue of constitutionality.

The leading case in this area is Featherstone v. Norman 170 Ga. 370, 153 S.E. 58 (1931), which held that a Georgia statute adopting the then current federal law was not an unconstitutional delegation because it did not incorporate future changes. A number of cases, several of which are included in an annotation at 42 ALR 2d 797, have followed the reasoning in Featherstone. Their holdings suggest that statutes purporting to include future amendments would have been invalidated.

The first case to speak directly to the issue of whether a state may constitutionally base its income tax scheme on the federal income tax law, including subsequent amendments, was Alaska Steamship Co. v. Mullaney, 12 Alaska 594, 180 F.2d 805 (C.A.9 1950). The Court of Appeals upheld the Alaska statute, reasoning that the legislature's action was "not a mere labor-saving device" but was "undertaken in order to attain a uniformity which is itself an important object." 180 F.2d at 816. The court stated its holding as follows:

> "Since the attainment of this uniformity was in itself a major objective of the Alaska legislature, in enacting that the

> local law must conform, the Alaska legislature, which alone could make this decision, was itself acting, and was not abdicting its functions, nor, in our opinion, making an invalid delegation to Congress". 180 F2d at 816

The only other case dealing with the constitutionality of a state statute expressly adopting future federal amendments is Anderson v. Tiemann, 182 Neb. 393, 155 N.W.2d 322 (1967). The Nebraska statute, which is identical to the Delaware statute quoted above, was enacted pursuant to a constitutional amendment providing that "the Legislature may adopt an income tax law based upon the laws of the United States." The legislative history of the statute disclosed an intent to include future changes. Relying heavily on the reasoning in Alaska Steamship Co., the Nebraska Supreme Court construed the constitutional amendment to permit the adoption of future federal law and upheld the statute.

Anderson v. Tiemann and Alaska Steamship Co., though not binding on the North Carolina courts, are certainly authority for the proposition that state laws adopting future federal changes are constitutional. Nevertheless, there is some doubt as to whether the North Carolina Supreme Court would uphold such a statute. The basis for this concern is the Court's treatment of an analogous issue, the delegation of legislative authority to administrative agencies.

The operative constitutional provisions in the administrative agency cases are Article I §6, providing for separation of powers, and Article II §1, vesting legislative power in the General Assembly. The Court has construed these sections quite narrowly and has devised rather stringent rules governing delegation to administrative agencies. The legislature may not delegate the power to make a law but may confer on an agency the authority to execute it, provided adequate guidelines are set out for the exercise of discretion by the agency. Coastal Highway v. Turnpike Authority, 237 N.C. 52, 74 S.E.2d 310 (1953). See also the cases cited in Unauthorized Delegation of Legislative Authority to Administrative Agencies, 11 Wake Forest Law Review 269 (1975).

Reasoning by analogy to the administrative agency cases, the Court would probably conclude that adoption of future amendments to the Internal Revenue Code constitutes an impermissible delegation of the power to make law. Conformity with the federal tax structure would be a radical departure from the existing North Carolina scheme. The magniture of the change would lead the court to be particularly cautious. Even though it would be entitled to a presumption of constitutionality, a statute which adopts by reference future amendments to the Internal Revenue Code would, in our opinion, be invalidated as an unconstitutional delegation of legislative power.

MRR:ceh